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In the Supreme Court of the United States

OCTOBER TERM, 1964

PEOPLE OF THE STATE OF CALIFORNIA AND PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

Petitioners,

vs.

LO-VACA GATHERING COMPANY, HOUSTON PIPE LINE COMPANY, and EL PASO NATURAL GAS COMPANY,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

Brief for Petitioners

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OPINIONS BELOW

The opinions of the United States Court of Appeals for the Fifth Circuit (R. 365-376), issued September 24, 1963, are reported at 323 F.2d 190 (5th Cir., 1963). The Federal Power Commission's Opinion and Order Determining Jurisdiction (R. 254-277), issued October 23, 1961, is reported at 26 FPC 606 (1961), and the Federal Power Commission's Order Denying Rehearing (R. 332-334), issued December 12, 1961, is reported at 26 FPC 840 (1961). The

initial decision of the Presiding Examiner (R. 204-257), issued August 11, 1961, is reported at 26 FPC 617 (1961).

JURISDICTION

The judgment of the Court of Appeals setting aside the Federal Power Commission's orders was entered on September 24, 1963. (R. 377). The People of the State of California and the Public Utilities Commission of the State of California (California) filed a timely petition for rehearing on October 14, 1963 (378-379), which petition was denied by order of the court (R. 379) issued December 17, 1963. A petition for a writ of certiorari was filed on March 31, 1964, and was granted on June 1, 1964. (R. 380).

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254 (1) and Section 19(b) of the Natural Gas Act.[1]

QUESTION PRESENTED

The question is whether an interstate stream of natural gas, destined for resale in interstate commerce and subject to the regulatory authority of the Federal Power Commission, may be contractually segregated so as to make a portion of that stream appear to be nonjurisdictional, and by this fiction remove such portion from said regulatory authority.

STATUTES INVOLVED

The pertinent provisions of the Natural Gas Act (Act of June 21, 1938, c. 556, 52 Stat. 821-833, 15 U.S.C. §§ 717-717w) are set out in the Appendix to this Brief.

STATEMENT

This proceeding involves the jurisdiction of the Federal Power Commission (Commission), under the Natural Gas Act, over separate sales of natural gas by Lo-Vaca Gathering Company

1. 52 Stat. 831, 15 U.S.C. § 717r(b).

(Lo-Vaca) and Houston Pipe Line Company (Houston) to El Paso Natural Gas Company (El Paso). The Commission found that Lo-Vaca and Houston were engaged in the transportation of natural gas in interstate commerce, and in the sale in interstate commerce of such gas for resale, and that they were natural gas companies within the meaning of the Natural Gas Act, and that their respective sales to El Paso were subject to the Commission's jurisdiction. (R. 273). The court below, in vacating the Commission's determination, found that Lo-Vaca and Houston had "carefully tailored their transactions" so as to place the sales beyond the Commission's regulatory powers. (R. 368).

El Paso is one of the major interstate pipeline companies of the nation, and is a natural gas company within the meaning of Section 2(6) of the Natural Gas Act.[2] (R. 3). El Paso is the principal supplier of natural gas to the California market. See *United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 658-659, fn 5 (1963). Approximately 80 per cent of El Paso's natural gas sales are made at the California border and this gas is ultimately consumed by millions of household and industrial consumers within California.

The most significant fact in this proceeding is that gas sold by Lo-Vaca and Houston will, through El Paso's facilities, reach California and will be consumed within California. (R. 56-57, 66). Consequently, California, as the consuming state, will be most seriously affected if this flow of gas to the California market is exempted from regulation.

A. The Lo-Vaca Sale.

Lo-Vaca is a corporation organized and existing under the laws of the State of Texas, and having its principal place of business in the City of Corpus Christi, Texas. (R. 121).

2. 52 Stat. 821, 15 U.S.C. § 717a(6). Appendix, p. 2.

On March 15, 1960, Lo-Vaca entered into a contract with El Paso whereby it would sell 50,000 Mcf per day of natural gas to El Paso at an initial price of 22 cents per Mcf, with periodic escalations during the 20 year term of the contract up to 26 cents. (R. 129, 142, 146). The gas will be required to meet specific quality standards set forth in the contract. (R. 136-137).

The March contract contains a so-called "restricted use" clause. The clause provides as follows:

> "All of the gas to be purchased by El Paso from Gatherer [Lo-Vaca] under this agreement shall be used by El Paso solely as fuel in El Paso's compressors, treating plants, boilers, camps and other facilities located outside of the State of Texas. It is understood, however, that said gas will be commingled with other gas being transported in El Paso's pipe line system." (R. 149).

The contract also contains the following provision:

> "It is the intent and understanding of the parties hereto that the sale of natural gas hereof is not subject to the jurisdiction of the Federal Power Commission because this sale is not for resale. * * *." (R. 142).

On May 16, 1960, Lo-Vaca and El Paso entered into a second contract which was identical to the first contract respecting quantity,[3] price and quality. (R. 153-177). However, this second contract did not contain a "restricted use" provision. Consequently, the May contract is involved in this proceeding only in so far as it covers an additional supply of natural gas which will be delivered to El Paso by Lo-Vaca simultaneously with the gas sold under the March "restricted use" contract. (R. 37, 122-123). Both contracts are the products of overlapping negotiations between the parties. (R. 58).

The Lo-Vaca gas, under both contracts, will be produced in the Gulf Coast area of the State of Texas and will be sold to

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3. This contract was amended on December 20, 1960, so as to change the estimated daily volume from 50,000 Mcf to 80,000 Mcf. (R. 360-362).

Lo-Vaca by four producers. (R. 123, 177). This gas will be delivered to El Paso Gas Supply Company (Supply Company), a wholly owned subsidiary of El Paso, at a point near Three Rivers, Live Oak County, Texas, to be known as Coquat Station.[4] (R. 24-25, 35-36, 46, 137, 161-162). Supply Company will receive the gas from Lo-Vaca for the account of El Paso with title and responsibility for the gas passing to El Paso. (R. 61, 123, 137, 162).

Both contracts provide that El Paso, at its own cost and expense, will install, maintain and operate at Coquat Station meters for measuring the quantity of gas delivered. (R. 138, 162). There are no definite plans for separately metering the volumes to be assigned to the "restricted use" contract and the volumes to be assigned to the other contract. (R. 59-60). The total Lo-Vaca supply, however, will be metered separately from a supply of gas to be delivered at Coquat Station by Houston (R. 60, 75-112).

The contracts provide that the determination of whether the gas delivered by Lo-Vaca conforms with the quality specifications will be made in accordance with generally accepted procedures of the industry. (R. 136, 161).

The physical identity of the Lo-Vaca gas under both the March and May contracts is lost when it is commingled at Coquat Station with gas received by El Paso from Houston. (R. 60). Moreover, there is no contractual or physical impediment to prevent gas from other sources from entering Coquat Station and being commingled therein. (R. 60).

All of the gas from Coquat Station, with the exception of some that will be consumed as compressor fuel, will be transported in a commingled stream to El Paso's Sonora facilities in Sutton County, Texas. (R. 60-61, 335). At Sonora the commingled stream

4. In a separate matter still pending before the Commission, *El Paso Gas Supply Co.*, FPC Dkt. No. CP60-101, Supply Company seeks authority to construct a compressor unit, called Coquat Station, at this delivery point, and to build a 227 mile pipeline from Coquat Station to a point of connection with El Paso's system at Sonora, Sutton County, Texas. (R. 35).

will enter El Paso's vast and intricate pipeline network which extends from Texas to the California border. (R. 335). Beyond Sonora natural gas from countless other sources also enters this giant system. (R. 61, 68-71, 358-359). Through this system Lo-Vaca gas will reach California. (R. 55).

B. The Houston Sale.

Houston is a corporation organized and existing under the laws of the State of Texas, having its principal place of business in the City of Houston, Texas. (R. 180).

On July 19, 1960, Houston contracted to sell to El Paso 70,000 Mcf per day of natural gas. (R. 75-112). The contract has a term of 20 years and the price, computed on Houston's cost of service, will initially approximate 19.5 cents per Mcf. (R. 94-97, 99). The gas to be delivered under the contract will be subject to various quality limitations. (R. 89, 93).

The Houston-El Paso contract contains the following "restrictive use" provision.

> "It is recognized that the construction by El Paso of a separate network of service pipe lines running to the various components of El Paso's plant located in Texas for delivery of gas for fuel purposes would be unnecessary duplication of facilities and economically prohibitive. Accordingly, it is recognized that any gas purchased hereunder from Houston for such fuel consumption within Texas must necessarily be commingled with other gas being transported by El Paso in its pipe line system. In this connection, El Paso represents and covenants that gas to be purchased by El Paso from Houston hereunder shall be used and consumed by El Paso solely as fuel in the operation of El Paso's plant and the gasoline plant of Phillips Petroleum Company in Ector County, all located wholly within the State of Texas. El Paso shall advise Houston as to each such utilization to be made of the gas purchased hereunder, and no new or different utilization of such gas shall be made by El Paso without the prior written consent of Houston. El Paso further covenants and agrees that at no

time during the term of this agreement will El Paso take from Houston a quantity of gas in excess of the quantity of gas being consumed at the same time in Texas by El Paso for uses agreed to hereunder by Houston. If, by inadvertence or mistake or for any other reason, El Paso shall at any time during the term hereof take from Houston hereunder a greater quantity of gas than is being so utilized, El Paso covenants that the same shall be sold or utilized by El Paso solely in intrastate commerce for use and consumption within the State of Texas." (R. 78-79).

Houston's gas will be produced in the State of Texas and will be supplied by Houston's own system. (R. 28, 50). It will be delivered to Supply Company, for El Paso's account, at Coquat Station. (R. 59, 82-83). The gas will be metered separately from the Lo-Vaca gas, or any other gas, being received at Coquat Station. (R. 59-61). The meters, at the point of delivery, will be installed, operated and maintained by Houston. (R. 83). El Paso will have the option, at its cost and expense, to provide a check meter. (R. 83). Provision for the measurement of heating content is specifically provided in the contract. (R. 93).

Title to the gas will pass to El Paso at Coquat Station. (R. 83). The Houston gas will there be commingled with the total supply of Lo-Vaca gas. (R. 36, 60). The commingled stream will proceed to Sonora and from there into El Paso's system. (R. 36, 55-57, 60-66).

The actual identity of the Houston gas will be lost when it is physically commingled with Lo-Vaca's gas at Coquat Station. (R. 60-61). Under the contract, however, El Paso will pretend that the Houston gas is being consumed in certain of its existing and proposed plants—all within the State of Texas. (R. 36-37). In these Texas plants El Paso will utilize, or will sell to Phillips Petroleum Company (Phillips) for utilization, volumes of natural gas from its system which are equal to or in excess of the volumes of gas purchased from Houston. (R. 68, 78-79). El Paso will operate at

these plants the meters necessary to prove that the consumption of system gas within Texas is equal to or greater than the volume of Houston gas entering the system. (R. 79).

El Paso has assured Houston that it is physically possible that some gas from the commingled stream leaving Coquat Station will flow to each of the designated plants and that, moreover, El Paso is prepared to realign its facilities to achieve such a flow.[5] (R. 34-35). This flow of system gas, as supplemented by the gas from Coquat Station, will be considered by El Paso as replacing the system gas now being consumed by existing plants. (R. 42, 344-345) In proposed plants El Paso will also indulge in the fiction that the system gas which will be burned therein will be Houston's gas.

C. Proceedings Before the Commission.

Pursuant to Section 7 of the Natural Gas Act,[6] Lo-Vaca, on June 1, 1960, applied to the Commission for a certificate of public convenience and necessity to gather and deliver natural gas under its March "restricted use" contract and to gather and sell natural gas under its May unrestricted contract. (R. 122).

On December 27, 1960, Houston filed a petition for a declaratory order under Section 16 of the Act[7] to remove uncertainty as to the jurisdiction of the Commission over its sale to El Paso and for a declaration by the Commission that it will have no jurisdiction over such sale because the sale will be wholly in intrastate commerce. (R. 179-192, 256).

5 In *El Paso Natural Gas Co.*, FPC Dkt. No. CP61-26, El Paso is seeking authority to construct certain facilities to transport volumes of its system gas to some of the plants where the Houston gas will supposedly be consumed (R. 38-39, 48-49). Other facilities for the same purpose were the subjects of applications in FPC Dkt. Nos. G-15696 and G-18616, which applications have been withdrawn by El Paso. (R. 49).

6 52 Stat. 824, 15 U.S.C. § 717f. Appendix, p. 3.

7 52 Stat. 830, 15 U.S.C. § 717o. Appendix, p. 6.

The Commission, on February 24, 1961, consolidated for hearing Lo-Vaca's application and Houston's petition for the limited purpose of resolving the questions of jurisdiction raised by the "restricted use" provisions. (R. 201-203). California intervened in the proceeding. (R. 197-200). Also intervening were three California distributing utilities, namely, Southern California Gas Company, Southern Counties Gas Company of California, and Pacific Gas and Electric Company. Transwestern Pipeline Company, another interstate pipeline company serving the California market, also intervened. Hearings were conducted before a presiding examiner on March 21-22, 1961, and April 10, 1961. (R. 19-71, 337-360).

D. The Presiding Examiner's Decision.

The initial decision of the presiding examiner was issued on August 11, 1961. (R. 204-237). The examiner held (1) that the Lo-Vaca sale to El Paso, under the "restricted use" contract, would be a sale of natural gas for resale in interstate commerce and would be subject to the Commission's jurisdiction, and (2) that the Houston sale would not be a sale of natural gas for resale in interstate commerce and, consequently, would be beyond the reach of the Commission's authority. Lo-Vaca's May unrestricted contract was held, as Lo-Vaca and El Paso had conceded, to be jurisdictional. (R. 216).

The examiner found that the Lo-Vaca and Houston gas would be physically commingled in El Paso's interstate transmission system, and that some part of the gas "inevitably would be *physically* transported in interstate commerce for resale in interstate commerce by El Paso for ultimate consumption in California * * *." (R. 210-211). The only "segregation" of the gas, the examiner found, would be by contract language.

In Lo-Vaca's case the examiner concluded that, in view of the commingling, some or all of Lo-Vaca's gas would in fact be resold

in interstate commerce, and that Lo-Vaca and El Paso could not remove the sale from the Commission's jurisdiction by agreeing that El Paso consume in its own facilities outside of Texas an amount of gas at least equal to the amount purchased from Lo-Vaca. (R. 226-235).

In Houston's case the examiner concluded that the gas would be produced wholly in Texas, transported wholly in Texas, and consumed wholly in Texas. Because the Houston gas would not be commingled with any gas from outside of the state, but would move with Texas produced gas only, the examiner found that interstate commerce would not be involved. (R. 224-226).

California, among others, filed exceptions to the examiner's decision. California's exceptions were directed to the examiner's failure to find that the Houston sale was also subject to the Commission's jurisdiction. (R. 238-253).

E. The Commission's Opinion.

On October 23, 1961, the Commission issued its Opinion No. 348 (R. 254-277) reversing that part of the examiner's initial decision pertaining to the Houston sale, and finding jurisdiction over Houston as well as over Lo-Vaca.

The Commission stated that the question presented was "whether contractual arrangements and the intentions of the parties can segregate Lo-Vaca's and Houston's gas sold to El Paso from other gas received by El Paso regardless of physical commingling, the actual destination of the gas, and the operations of El Paso's system." (R. 262). In answering this question in the negative, the Commission found that the Lo-Vaca and Houston gas would actually, in part at least, be resold to customers outside the State of Texas inasmuch as it would be physically impossible to restrict the use of this gas to certain facilities as was the intention of the contracting parties. The Commission held both sales to be sales in interstate

commerce for resale within the meaning of Section 1(b) of the Natural Gas Act.[8]

The Commission first considered the reality of the commerce involved:

> "It is the 'nature of the beast' not the label that is controlling. It has been held that whether a transaction is in interstate commerce is determined by the essential character of the commerce, not necessarily by the contract." (R. 266).

The facts, as viewed by the Commission, demonstrated that the character of the Lo-Vaca and Houston sales was indeed essentially interstate commerce:

> "El Paso is engaged in an enterprise extending from Texas to California and from Mexico to Canada. The record in this case shows that its gas produced or purchased in Texas goes to a number of possible destinations. Some is consumed in Texas, but most of it is transported out of the state in El Paso's pipeline system to be consumed in pipeline facilities or resold in New Mexico, Arizona or California. The contractual provisions, of course, do not alter these physical facts. Neither is the situation altered by El Paso's proposal to build a 16-inch line west from its Keystone compressor station so that there would be a line wholly in Texas by which fuel could reach its Texas compressor stations, for the Houston gas commingled with other gas in El Paso's main line would physically move out of Texas although some portion might travel through the proposed 16-inch line.
>
> "The way in which El Paso operates its system in transporting its gas from the sources of supply to the points where it is needed as discussed in part above, demonstrates that the system must be considered as a whole and that it has the primary purpose of moving gas from the Permian Basin and other sources to consumers in a number of states." (R. 267-268).

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8. 52 Stat. 821, 15 U.S.C. § 717(b). Appendix, p. 1.

The Commission concluded that a sale of gas to El Paso's interstate system, to be used for system purposes and in part to be sold for resale outside the State of Texas, was within its jurisdictional authority. The Commission added: "The gas to be sold to El Paso by Lo-Vaca and Houston would be isolated only by terms of the contracts but actually would become system gas along with gas of other producers who did not receive this contractual treatment." (R. 268).

The Commission held "that a sale of gas in interstate commerce for resale cannot be transmuted into something else by contractual provisions." (R. 272).

One Commissioner dissented respecting the Houston sale. (R. 274-277).

F. Proceeding in the Court of Appeals.

On February 6, 1962, Lo-Vaca, Houston and El Paso filed in the United States Court of Appeals for the Fifth Circuit a joint petition to review the Commission's decision. (R. 1-18). California and Southern California Gas Company and Southern Counties Gas Company of California (Southern California Companies) were granted leave to intervene in support of the Commission in the court proceeding.

1. The Majority Opinion.

On September 24, 1963, the court issued its decision which vacated the order of the Commission under review. (R. 365-372). The court relied upon *United States v. Public Utilities Commission*, 345 U.S. 295, 318 (1953), wherein this Court, in considering whether a distinction for jurisdictional purposes could be made between a part of a sale of electric energy in California which would be used by the purchaser for its own industrial needs in Nevada and a part of the same sale of electric energy which would be resold by the purchaser to others in Nevada, stated that

such separability would turn on whether "an essentially separate transaction covering the power directly consumed by the purchaser is identifiable." The Fifth Circuit found that Lo-Vaca, Houston and El Paso "carefully tailored their transactions to fit the above *caveat*." (R. 368).

The majority of the court, in vacating the Commission's decision, relied also upon *City of Hastings v. Federal Power Commission*, 221 F.2d 31 (D.C. Cir. 1954), cert. denied, 349 U.S. 920 (1955), and *North Dakota v. Federal Power Commission*, 247 F.2d 173 (8th Cir. 1957). The *City of Hastings* case, the court held, stood for the proposition that a direct sale of natural gas in interstate commerce to a city for plant fuel, even if commingled with gas also sold to the city for resale, is nonjurisdictional if the sale were covered by a separate rate and contract. (R. 368-369). The *North Dakota* case, the court stated, affirmed a finding of nonjurisdiction over gas produced and consumed in the State of North Dakota but commingled for transmission purposes with gas moving in interstate commerce. (R. 369-370).

The Commission's decision, the court continued, "ignores the nature of natural gas." (R. 370). The court explained:

> "Must petitioners [Lo-Vaca, Houston, and El Paso] be driven to the unnecessary expense of constructing a parallel line to carry the 'non-jurisdictional' gas or to some plan devised so that the requisite volume of gas is transported daily through the line enclosed in a sort of balloon-like envelope? Besides the question of whether such expense or cost would be allowed in computing rates to consumers, the suggested question answers itself. We are dealing with legal concepts, not Rube Goldberg devices which would waste the resources of the gas industry and the nation." (R. 371, fn 6).

In concluding, the court considered the argument advanced by the California intervenors that the Commission must protect consumers against unregulated costs for jurisdictional services affect-

ing interstate commerce. The Court said that such a plea must be made to Congress and not to the judiciary. (R. 371).

2. The Dissenting Opinion.

In his dissenting opinion Judge Rives urged that jurisdiction should not turn on contract clauses that do not correspond and are not intended to correspond to reality. (R. 376). Whether gas is transported in interstate commerce or sold in interstate commerce for resale depends, according to the dissenting opinion, "not on what the parties say about the transaction but on what is done with the gas." (R. 376).

Relying upon this Court's opinion in *Connecticut Light & Power Co. v. Federal Power Commission*, 324 U.S. 515, 529 (1945), the dissenting opinion stated: " 'Federal jurisdiction was to follow the flow of electric energy, an engineering and scientific, rather than a legalistic or governmental, test.' " (R. 376). Likewise, according to the approach of the dissenting judge, federal jurisdiction was to follow the flow of natural gas.

3. Petitions for Rehearing.

Petitions for rehearing of the court's decision were filed by California, the Commission and the Southern California Companies. The petitions were denied by order of the court, without opinion, dated December 17, 1963. (R. 379).

SUMMARY OF ARGUMENT

Lo-Vaca and Houston are engaged in the business of supplying natural gas to El Paso, an interstate pipeline company whose principal business, in turn, is supplying natural gas to the California market. These parties, by contractual intention without physical implementation, seek to direct a portion of an interstate stream of natural gas, destined for resale in an interstate market, to non-jurisdictional utilization. Under so-called "restricted use" provi-

sions in their contracts gas sold by Houston to El Paso will be considered *as if* it were consumed within the borders of the producing state, and gas sold by Lo-Vaca will be considered *as if* it were sold to El Paso for its own general use outside of the producing state. Placing contractual stipulations aside, the gas will actually flow in interstate commerce for resale in interstate commerce.

The Commission has jurisdiction over all sales of natural gas for resale in interstate commerce. The foundation for this jurisdiction is the fact of physical flow. Thus, contractual language purporting to restrict the flow is immaterial and inconsequential when the physical arrangements of the contracting parties, in compliance with the contract, do not restrict the flow at all.

Commission jurisdiction is based upon what is done with the gas in the context of a comprehensive regulatory scheme, and this jurisdiction cannot be subverted by fiction. Allowing the Lo-Vaca and Houston sales to escape regulation will open an "attractive gap" in the regulatory scheme envisioned by Congress. To permit this gap to remain open on the basis of mere agreements, divorced from fact, which pretend to move gas in a manner in which it cannot be moved, will produce regulatory chaos.

The interests of primary concern here are national rather than local. This Court must decide the case in the manner which will best promote the congressional policy directed towards effective regulation in the public interest. Such congressional policy, embodied in the Natural Gas Act, does not countenance "attractive gaps" in the comprehensive regulatory scheme created by the Act.

Argument

I.

THE COMMISSION HAS JURISDICTION OVER THE HOUSTON AND LO-VACA SALES FOR THE REASON THAT THE GAS SOLD WILL ACTUALLY FLOW IN INTERSTATE COMMERCE AND WILL BE SOLD FOR RESALE IN INTERSTATE COMMERCE.

A. The Commission Has Jurisdiction Over All Sales of Natural Gas for Resale in Interstate Commerce.

Some of the early attempts by the states to regulate the natural gas industry failed because the states' regulatory powers were unlawfully extended into the domain of interstate commerce. *State Corporation Commission of Kansas v. Wichita Gas Co.*, 290 U.S. 561, 563-564 (1934); *Missouri v. Kansas Gas Co.*, 265 U.S. 298, 307-308 (1924). As a result a regulatory void existed which Congress filled with the passage of the Natural Gas Act in 1938.

Section 1(b) of the Natural Gas Act provides as follows:

> "The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

This statute imposed federal jurisdiction over *all* sales of natural gas for resale in interstate commerce. This was a jurisdictional grant in an area which was beyond the reach of the regulatory power of any individual state. See *Public Utilities Commission v. Attleshoro Steam & Electric Co.*, 273 U.S. 83, 90 (1927).

The case at bar represents the elaborate efforts of two companies, aided by a third, to sell their gas within this area of exclusive federal jurisdiction unimpeded by the exercise of federal authority.

This is not a case presenting a contest between federal and state agencies as to which agency, federal or state, shall regulate a particular sale of gas. The question here is whether Houston and Lo-Vaca, assisted by El Paso, can succeed in removing their gas from the jurisdictional embrace of Section 1(b).

Section 1(b) encompasses all sales for resale in interstate commerce for ultimate public consumption. There are no exceptions. As this Court said in *Panhandle Eastern Pipe Line Co. v. Public Service Commission*, 332 U.S. 507, 517 (1947):

> "The line of the statute was thus clear and complete. It cut sharply and cleanly between sales for resale and sales for consumptive uses. No exceptions were made in either category for particular uses, quantities or otherwise."

If Lo-Vaca's and Houston's gas is sold for resale in interstate commerce, which California contends is a fact, then federal jurisdiction is required. No special exemption is available to Lo-Vaca and Houston which would enable them to escape federal regulation and still sell their gas for resale in interstate commerce.

By contractual language Lo-Vaca attempts to characterize its "restricted use" sale as a direct, industrial sale to El Paso. Houston, in the same manner, characterizes its sale as one made in intrastate commerce. Thus, by such characterizations, they expect to place themselves and their sales within the exclusionary provisions of Section 1(b).[9] In *Interstate Natural Gas Co. v. Federal Power Commission*, 156 F.2d 949, 951 (5th Cir. 1946), affirmed, 331 U.S. 682 (1947), the court rejected a similar attempt to escape regulation where the petitioner therein characterized certain sales so as to bring them within a statutory exception. The court stated:

> "We think petitioner's difficulties in construction and interpretation arise out of the fact that, treating unlike things as

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9. The provisions of the Natural Gas Act "shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas."

alike, it tries to read the exception with respect to production or gathering as an exception with respect to sales. There is no warrant in the act for so doing. It is very simply and plainly written. After stating what it shall apply to, it then states what it shall not apply to. Under familiar rules of construction, *a negation in or exception to a statute will be construed so as to avoid nullifying or restricting its apparent principal purpose and the positive provisions made to carry them out.* No conflict with them will, therefore, be found unless the conflict is clear and inescapable and then only in the precise point of the conflict." (Emphasis supplied).

The principal purpose and the positive provision of the Natural Gas Act is that federal jurisdiction shall govern sales for resale in interstate commerce. If parties are enabled to defeat this principal purpose and positive provision by mere words, then effective regulation under the Natural Gas Act cannot be achieved.

B. Lo-Vaca's and Houston's Gas Will Be Physically Sold for Resale in Interstate Commerce.

The record demonstrates that the Lo-Vaca and Houston transactions will result in sales for resale in interstate commerce, and that both transactions fall into the category of sales which are subject to the Commission's regulatory power.

Contractual language purporting to restrict the gas is misleading. The Lo-Vaca and Houston gas is not restricted in any sense of the word. The restrictions are placed upon El Paso, as purchaser, and relate to the utilization of the gas. The proposed flow of the gas shows that the gas will not be utilized for nonjurisdictional purposes but will be physically transported in interstate commerce for resale in interstate commerce by El Paso.

At the outset Lo-Vaca's "restricted use" supply will be commingled with another supply of gas, also from Lo-Vaca, which will be subject to the Commission's jurisdiction. (R. 22, 37, 59-60, 122-123). The total Lo-Vaca supply will then be commingled with the

Houston supply. (R. 59-60). The point of commingling is El Paso's proposed Coquat Station. (R. 60).

Some gas will be consumed as fuel in the Coquat Station compressors. (R. 61). The remainder, under pipeline pressure, will be transmitted to El Paso's existing plant at Sonora. There the gas enters El Paso's system. (R. 61). Beyond Sonora, the gas mixes with gas from other sources joining the Sonora line. (R. 61-62). At Benedum Junction in Upton County, Texas, the line divides. (R. 335). One segment of the commingled stream flows through a vast system of pipes, valves and compressors to Plains, Texas, where it joins El Paso's northern mainline which carries gas to the California border. (R. 335). The other segment flows through another complex network, reaches El Paso's southern mainline, and arrives at the California border. (R. 335).

Lo-Vaca, Houston and El Paso concede that the commingled stream which originates at Coquat Station will flow to California, and concede they must, for there will be no attempt to physically prevent the Lo-Vaca and Houston supplies from being resold in interstate commerce. (R. 55).

The court below recognized the physical reality of the gas flow. The court said:

> "[The Commission] urges that the fact is that some, and actually most, of the molecules sold will *actually* be resold in interstate commerce. This physical fact cannot be doubted, gas being the substance it is * * *". (R. 367).

The undisputed physical fact that Houston's and Lo-Vaca's gas will be resold in interstate commerce is the statutory base upon which the Commission's jurisdiction rests. *Federal Power Commission v. Natural Gas Pipeline Co.*, 315 U.S. 575, 582 (1942). Other considerations are immaterial and inconsequential.

C. The Physical Flow of Gas in Interstate Commerce for Resale Is the Foundation for the Commission's Jurisdiction.

In a line of cases involving natural gas energy and electric energy, this Court's jurisdictional decisions have been based upon the fact of flow. *Federal Power Commission v. East Ohio Gas Co.*, 338 U.S. 464, 467 (1950); *Colorado-Wyoming Gas Co. v. Federal Power Commission*, 324 U.S. 626, 629-631 (1945); *Interstate Natural Gas Co. v. Federal Power Commission*, 331 U.S. 682, 687-688 (1947); *Jersey Central Power & Light Co. v. Federal Power Commission*, 319 U.S. 61, 68-72 (1943); *Illinois Natural Gas Co. v. Central Illinois Public Service Co.*, 314 U.S. 498, 503-504 (1942).

In *Federal Power Commission v. Southern California Edison Co.*, 376 U.S. 205, 209, fn 5 (1964), this Court stated:

> "'[F]ederal jurisdiction was to follow the flow of electric energy, *an engineering and scientific, rather than a legalistic or governmental, test.' Connecticut Light & Power Co. v. Federal Power Commission*, 324 U.S. 515, 529."

The fact of flow cannot be changed by contractual provisions respecting the disposition of the gas. The Commission stated in its decision below that it "is the 'nature of the beast' not the label that is controlling." (R. 266).

D. Labels Cannot Alter the Physical Flow of Gas.

El Paso is presently utilizing its system gas for fuel to operate facilities and plants both inside and outside of Texas. In these existing facilities and plants only the label of the gas now being burned as fuel will be changed by the Houston and Lo-Vaca transactions. (R. 36-37, 358-359). Gas presently being consumed as fuel in Texas, or resold to Phillips in Texas, will be labeled "Houston gas"; gas presently being burned as fuel in El Paso's compressors outside of Texas will be called "Lo-Vaca gas".

El Paso's ability to use part of its total supply of system gas to satisfy its own need for compressor fuel or to sell part of its supply to others in intrastate commerce is not questioned. Nor is it questioned that the volumes so consumed will at least equal the volumes received from Lo-Vaca and Houston. However, the gas so consumed will not necessarily be Houston's gas or Lo-Vaca's gas. It might be anybody's gas or everybody's gas. It might be gas under old contracts, new contracts or future contracts. It might even be gas presently subject to the Commission's jurisdiction.

El Paso's agreements with Lo-Vaca and Houston, which attempt to segregate by label gas which physically flows in interstate commerce and which is sold for resale, change nothing. Likewise, intricate metering by El Paso, which assures that the volumes of gas consumed in compressors, treating plants, boilers and other facilities throughout Texas, New Mexico and Arizona at least equal the volumes purchased from Lo-Vaca and Houston, changes nothing. The mechanical operation of meters, at points where El Paso's interstate stream is tapped, cannot decide, for all purposes, which gas is subject to the Commission's jurisdiction and which is not. The Court stated, in *Panhandle Eastern Pipe Line Co. v. Public Service Commission*, 332 U.S. 507, 512 (1947), that "mechanical considerations are no longer effective, if ever they were exclusively, to determine for regulatory purposes the interstate or intrastate character of the continuous movement and resulting sales we have here." Mechanical metering devices cannot change gas, which in the pipeline is destined for interstate commerce, into a commodity in intrastate commerce; nor can they change gas, otherwise directed for resale in other states, into a direct sale not subject to regulation.

E. Contractual Segregation of Houston's or Lo-Vaca's Gas Is Not Possible.

The court below held that El Paso could indeed contractually segregate "Houston gas" and "Lo-Vaca gas." The court said: "Gas in a pipeline can be separated only 'on paper' or conceptually, or, at least, this is the cheapest and most practical way to do it." (R. 370-371). The court principally relied upon *United States v. Public Utilities Commission*, 345 U.S. 295 (1953); *City of Hastings v. Federal Power Commission*, 221 F.2d 31 (D.C. Cir. 1954), cert. denied, 349 U.S. 920 (1955), and *North Dakota v. Federal Power Commission*, 247 F.2d 173 (8th Cir. 1957). Under the facts of the case at bar, only the *Public Utilities Commission* case has application—but not for the reasons advanced by the court.

1. United States v. Public Utilities Commission.

This case, relied upon by the court below, resulted in a finding of Commission jurisdiction—a different result from that reached in the decision below. The conflict in the *Public Utilities Commission* case was between state regulation or federal regulation. California Electric Power Company agreed to sell electric energy to the Navy Department in California. Part of the energy was to be directly consumed by the Navy in Nevada; the remainder was to be resold by the Navy to military dependents in Nevada. The California Public Utilities Commission asserted jurisdiction over at least that portion of the sale that was to be directly consumed and not resold. *California Electric Power Co.*, 50 Cal. P.U.C. 749, 754-759 (1951). This Court, in finding that federal jurisdiction attached, observed that the portions could not be separated because there was "no record evidence of separate rates, separate negotiations, separate contracts or separate rate regulation by official bodies * * *." 345 U.S. at 318.

The court below construed the *Public Utilities Commission* case to the effect that if California Electric Power Company and

the Navy had provided for separate sales, the energy could have been divided for jurisdictional purposes. The court concluded that Houston and Lo-Vaca had "carefully tailored their transactions to fit the above *cat eat*." (R. 368).

Houston and Lo-Vaca did identify their sales by separate rates and separate contracts. But they did not bring their sales within any *"cat eat"* of the *Public Utilities Commission* case. The electric energy involved in that case and sold to the Navy was delivered to the Navy as a 55,000 volt load in California. The Navy transmitted the energy into Nevada over its own line where it consumed part in official industrial operations and resold the remainder, between 15% and 29% of the total, to its military dependents in Nevada. This Court, while not deciding the issue, stated that if California Electric Power Company and the Navy had had separate transactions relating to the separate uses, then it might have been possible to fix the limits of federal jurisdiction. 345 U.S. at 317-318. But the record would not permit such a finding. 345 U.S. at 318.

If Houston and Lo-Vaca, by separate contracts, were to sell a total of 120,000 Mcf per day of the same quality of natural gas to El Paso, and El Paso were to consume 70,000 Mcf of the commingled Houston-Lo-Vaca stream within Texas, and were to transport the remaining 50,000 Mcf of that commingled stream for its own use as compressor fuel outside of Texas, all without any possibility of commingling supplies of natural gas from any other supplier, then it might be argued that the parties had "carefully tailored" their contracts to fit the facts of the *Public Utilities Commission* case. However, the Houston and Lo-Vaca "restricted use" gas will be commingled at the very outset in Coquat Station with Lo-Vaca's unrestricted gas. Thereafter, the total supply leaving Coquat Station will be further commingled with gas purchased from numerous other suppliers in Texas and New Mexico. (R. 343-359).

Unlike the situation in the *Public Utilities Commission* case, where the total supply of electric energy sold to the Navy and generated in California was isolated in the Navy's line and the proportion of the total assigned to each use could be determined, the Houston and Lo-Vaca "restricted use" gas will not be isolated in any pipeline, system or facility of El Paso, inasmuch as this gas is commingled with Lo-Vaca's unrestricted gas at the outset—at the point of delivery to El Paso at Coquat Station. In order to achieve contractual segregation, as suggested by the Court, it would be necessary to assume that the Houston and Lo-Vaca supplies were of the same quality and that they, in a commingled status, were somehow isolated in El Paso's system. Then, it would be possible to conceive that one portion of the commingled Houston-Lo-Vaca supply might be utilized for one purpose and the remaining portion utilized for another purpose.

If contractual segregation had been accomplished in the *Public Utilities Commission* case, the California Public Utilities Commission would have had jurisdiction over the sale in California to the Navy Department for its own use, and the Federal Power Commission would have had jurisdiction over the sale of energy resold by the Navy. In the case at bar, by contrast, contractual segregation will result in the sales of Houston and Lo-Vaca going unregulated.

The State of Texas has no conceivable interest in regulating the Houston and Lo-Vaca sales.[10] The parties to be most seriously affected by the sales reside in California, for the cost of the Houston and Lo-Vaca gas will be included within El Paso's cost of service upon which El Paso's rates, paid principally by consumers in California, will be based. Moreover, according to the

10. Whether the State of Texas would have the power to regulate these sales is also questionable. Since the gas involved will actually flow in interstate commerce and will be resold in interstate commerce, constitutional limitation under the Commerce Clause would appear to preclude an assertion of state jurisdiction. See *Public Utilities Commission v. Attlesboro Steam and Electric Co.*, 273 U.S. 83, 88-90 (1927).

attempted contractual segregation, the gas purchased will supply and operate facilities which will perform jurisdictional services for El Paso, such as compressing gas for transmission in interstate commerce. Furthermore, the Houston and Lo-Vaca supplies will be transported within a system which is essentially paid for through rates charged to the California consumers. The sales, then, are not peculiarly of local concern to Texas, or within the class with which Texas might appropriately deal in making reasonable provision for local needs. See *Pennsylvania Gas Co. v. Public Service Commission*, 252 U.S. 23, 30 (1920).

The *Public Utilities Commission* case has direct application to this proceeding because this Court, in holding that the total supply of energy was subject to federal regulation, looked at the actual flow of the energy. This Court said:

> "Certainly the concrete fact of resale of some portion of the electricity transmitted from a state to a point outside thereof invokes federal jurisdiction at the outset, despite the fact that the power thus used traveled along its interstate route 'commingled' with other power sold by the same seller and eventually directly consumed by the same purchaser—distributor * * *." 345 U.S. at 316.

2. City of Hastings v. Federal Power Commission.

City of Hastings v. Federal Power Commission, 221 F.2d 31 (D.C. Cir. 1954), cert. denied, 349 U.S. 920 (1955), is the case which the court below found "strikingly similar" to the Lo-Vaca proposal. (R. 368-369). This case arose upon complaint by the City of Hastings, Nebraska, against Kansas-Nebraska Natural Gas Company—an interstate pipeline company. The city received gas from the pipeline at city-gate delivery points. The city utilized part of the total supply received to generate electric energy and part for resale to local consumers. The pipeline company's tariff, on file with the Commission, specifically excluded the gas directly consumed by the city in its power plant. The city complained that

the total gas supply constituted one sale which was subject to the Commission's jurisdiction. The Commission found that the natural gas consumed in the power plant was a direct sale for the city's own use, and hence not within the jurisdictional grant of Section 1(b) of the Natural Gas Act. The United States Court of Appeals for the District of Columbia Circuit affirmed the Commission's decision.

City of Hastings involved an isolated supply of natural gas not unlike the isolated supply of electric energy sold in the *Public Utilities Commission* case. The purchasing city put the supply to two separate uses, each being distinguishable, and each serving as a basis for a separate transaction. By reference to the separate transactions the proportion of the total supply furnished could be ascertained as to use for each purpose.

Under the Lo-Vaca transaction it is impossible to segregate contractually Lo-Vaca's gas as to use. The total Lo-Vaca supply, a part of which is assigned to the March "restricted use" contract and a part of which is assigned to the May unrestricted contract, will be somewhere within El Paso's system, but no one will know precisely where. This supply cannot be separated as to use, nor can the gas sold under the March contract be separated as to use from all of the remaining gas in El Paso's system. The reason is that the Lo-Vaca gas, unlike the *City of Hastings* gas, cannot be traced from the point of delivery where it is received by the purchaser to the point of ultimate use. Under the Lo-Vaca proposal the physical reality of the fact of flow is ignored.

The denial of federal jurisdiction in the *City of Hastings* case apparently resulted in jurisdiction passing to the State of Nebraska. The court said:

> "[A] tap line from Kansas-Nebraska's interstate line to the power plant would have served the power plant fuel needs, and the State of Nebraska would have had 'full power under the act and the decisions to regulate such direct sales of natural gas for consumption within its borders.' Colorado In-

terstate Gas Co. v. Federal Power Commission, 3 Cir., 1950, 185 F.2d 357, 361. See also, Panhandle Eastern Pipe Line Co. v. Michigan Public Service Commission, 1951, 341 U.S. 329, 334, 71 S. Ct. 777, 95 L.Ed. 993." 221 F.2d at 33.

The denial of federal jurisdiction in the Lo-Vaca instance will result in no regulation. The States of California, New Mexico and Arizona cannot regulate a sale made in Texas. Nor could Arizona or New Mexico regulate the sale simply because the facilities slated to use the gas, under the contractual segregation hypothesis, are located in those states. Moreover, these facilities are subject to the Commission's jurisdiction.

Congress did not contemplate ineffective regulation at either the state or federal level, but rather a scheme of comprehensive regulation. *Panhandle Eastern Pipe Line Co. v. Public Service Commission*, 332 U.S. 507, 520-521 (1947). The *City of Hastings* case is consistent with this congressional purpose. The Lo-Vaca proposal is to the contrary.

3. North Dakota v. Federal Power Commission.

North Dakota v. Federal Power Commission, 247 F.2d 173 (8th Cir. 1957), involved the sale of natural gas from the tailgate, or outlet, of an extraction plant in the State of North Dakota to Montana-Dakota Utilities Company, an interstate pipeline company. From the plant, located in the northwestern quarter of the state, the pipeline company constructed a pipeline traveling generally westward into the State of Montana. The pipeline company contracted with North Dakota producers supplying gas to the plant for a "firm" supply which would be transported in this western line and resold to several communities in North Dakota. The pipeline also contracted with the same producers for a supply of "dump", or surplus, volumes from the plant. The "dump" supply would be transported in the same line but, by contractual segregation, would be considered as crossing the border into

Montana for eventual resale. In effect, additional volumes in the line, not committed for North Dakota consumption, would be resold in interstate commerce.

The United States Court of Appeals for the Eighth Circuit upheld a decision of the Commission, attacked by the State of North Dakota and its Public Service Commission, that the "firm" supply was a separate transaction and was not a sale in interstate commerce.

The court below related the facts of the *North Dakota* case to Houston's proposal. (R. 369-370).

> The *North Dakota* case has no application under the facts of the case at bar. The "firm" supply and the "dump" supply involved in *North Dakota* consisted of residue gas from the tailgate of the plant. This was the only gas in the pipeline company's western line. As in the *City of Hastings* case, *supra*, the total supply lent itself to being proportionally separated at one point for one purpose, and at another point for another purpose. The contracts separated a measurable part of the whole for use in North Dakota and another measurable part for use outside of the state. This arrangement was also consistent with the *Public Utilities Commission* case, *supra*, where the Navy's entire supply of energy was capable of being segregated as to use.
>
> The *North Dakota* situation is not applicable to the Houston proposal. Houston's gas, commingled within El Paso's interstate system, is not capable of being segregated by El Paso for any specific use. There is no conceivable way of committing all or any portion of the Houston supply to performing a particular service.

The "firm" sale in *North Dakota* presented a proper case for local regulation. The petitioning parties were the State of North Dakota and its Public Service Commission, on behalf of local consumers. The court said:

> "While the court recognizes the petitioners' proper concern for the interests of North Dakota natural gas consumers in

the newly developing market area, the conclusion is inescapable that jurisdiction rests not with the FPC but with the petitioners themselves." 247 F.2d at 178.

The Houston sale, on the other hand, will go unregulated because California, with interests like those of the petitioners in *North Dakota*, is in this case powerless to act.

In *North Dakota* the utilization which was declared to be beyond federal regulatory powers concerned a sale for resale to ultimate consumers in the State of North Dakota. This sale, like the direct sale to the city's power plant in *City of Hastings*, can burden no other state except the state in which the sale is made. But the Houston sale, like the Lo-Vaca sale, requires that some gas be drawn out of El Paso's system and directed to compressor stations and other facilities which, whether located in Texas, or outside of Texas, make up parts of El Paso's integrated, interstate system. The customers of this system are burdened by the Houston sale, and their remedy rests upon a finding of Commission jurisdiction.

II.

COMMISSION JURISDICTION IS BASED UPON WHAT IS DONE WITH THE GAS IN THE CONTEXT OF A COMPREHENSIVE REGULATORY SCHEME AND CANNOT BE SUBVERTED BY FICTION.

A. Congress Intended a Comprehensive and Effective Regulatory Scheme.

This Court has consistently held that the purpose of the Natural Gas Act is "to create a comprehensive and effective regulatory scheme * * * to protect consumers against exploitation at the hands of natural-gas companies." *Panhandle Eastern Pipe Line Co. v. Public Service Commission*, 332 U.S. 507, 520 (1947). See also *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 611 (1944); *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672, 685 (1954).

The comprehensive scheme was designed to permit federal regulation to supplement state regulation. *Federal Power Commission v. East Ohio Gas Co.*, 338 U.S. 464, 470-471 (1950); *Panhandle Eastern Pipe Line Co. v. Public Service Commission*, 332 U.S. 507, 517-519 (1947). The Natural Gas Act defines this federal authority in terms of transportation in interstate commerce and sales in interstate commerce for resale. This Court, in *Federal Power Commission v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 19 (1961), noted, however, that these terms are frequently, standing alone, of little help in the solution of a borderline case. This Court, thus, laid down a "broader principle" to be utilized in deciding jurisdictional questions:

> "[I]n a borderline case where congressional authority is not explicit we must ask whether state authority can practically regulate a given area and, if we find it cannot, then we are impelled to decide that federal authority governs." 365 U.S. at 19.

This Court further stated that "Congress did not desire an 'attractive gap' in its regulatory scheme; rather, Congress intended to impose a comprehensive regulatory system on the transportation, production, and sale of this valuable natural resource." 365 U.S. at 28.

The decision of the court below opens an "attractive gap" in the comprehensive and effective regulatory scheme. The court said:

> "We must appreciate the concern of the California intervenors for the price paid for the non-jurisdictional [Houston's and La Vaca's] gas. Their plea should be made, however, to Congress and not to us. The courts are not competent to make legislative decisions as to whether jurisdiction *should* be given the Commission under varying circumstances; the scope of our function is to determine whether such jurisdiction *does* attach, as the statute is written. It may well be that the State of Texas has no incentive to regulate the cost of such gas; this, however, has no relevance in interpreting the

statute, though it may have relevance in drawing or redrawing it. Our duty of statutory construction is limited to construing statutes, not constructing them." (R. 371).

Thus, the consumers, in whose interest the Natural Gas Act was designed, are without an existing remedy and are left unprotected. Yet, rates and charges exacted by Houston and Lo-Vaca for their gas become fixed items of El Paso's cost of service which may be charged to the subsequent purchasers of the gas, including the ultimate consumers. When it is recalled that El Paso is a major interstate pipeline company whose every function affects numerous states, the approval by the court below of "restricted use" sales, which escape all regulation, is repugnant to the congressional plan.

B. The "Attractive Gap" Must Be Closed by the Recognition of Federal Jurisdiction Over the Houston and Lo-Vaca Sales.

Unlike the final result reached in *City of Hastings v. Federal Power Commission*, 221 F.2d 31 (D. C. Cir. 1954), cert. denied, 349 U.S. 920 (1955), and *North Dakota v. Federal Power Commission*, 247 F.2d 173 (8th Cir. 1957), or the result adverted to in *United States v. Public Utilities Commission*, 345 U.S. 295 (1953), the result in the case at bar is nonregulation. In the above-mentioned cases, relied upon by the court below, the denial of federal jurisdiction meant that North Dakota, Nebraska and California — the states where the sales were made—could exercise their own regulatory authority. The State of Texas, where the Houston and Lo-Vaca sales will be made, has no asserted or conceivable interest in regulating sales of natural gas the costs of which are to be borne by those outside of the state and principally by California consumers.

Where a regulatory problem oversteps the bounds of any one state and it is improbable that state commissions could or would attempt to deal with the problem presented, then federal regula-

tion is absolutely essential. *Federal Power Commission v. Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1, 27 (1961).

The gap opened by the court below is indeed an attractive one. Relying upon the decision below, it would now be possible for a pipeline company to offer to purchase gas at a higher price than the Commission would otherwise authorize upon the recital that the gas would be used in its local compressors or would be delivered to intrastate customers only. It would, furthermore, be possible for the pipeline company to discriminate among its suppliers by giving certain ones the privilege of selling gas which by agreement would be deemed to be segregated from the interstate stream and resold and consumed in the state of production, or to be used in compressor stations. The possibilities are limitless. It is not inconceivable to imagine the pipeline company telling the Commission that system gas being consumed in Plant A is Supplier B's gas, or that gas in Compressor C once belonged to Supplier D, or that gas heating Building E was purchased from Supplier F.

The gas involved in this proceeding will be produced in the Gulf Coast area of the State of Texas, and will be sold under Houston's and Lo-Vaca's "restricted use" contracts at initial prices of 19.5 and 22 cents per Mcf, respectively. If these "restricted use" sales to El Paso were made by producers the prices would go unregulated even though they exceed the Commission's *Statement of General Policy No. 61-1* price of 16 cents per Mcf[11] for the area in question. The opportunity afforded by this attractive gap would be open to all producers and the efforts of the Commission to stabilize gas prices through the Policy Statement would suffer a serious setback.

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11. Statement of General Policy No. 61-1, 18 C.F.R. Sec. 2.56. See *Wisconsin v. Federal Power Commission*, 373 U.S. 294, 302, 313 (1963).

C. A Sale of Gas in Interstate Commerce Cannot Be Transmuted Into Something Else by Fiction.

The transactions of Houston and Lo-Vaca represent the ingenuity and imagination of fiction writers more than they represent the practicalities of the men who sell and transport an important natural resource. The contracting parties have made every effort to obscure realities and to emphasize fiction in their own unique version of contractual segregation. In their endeavors to escape regulation through the "restricted use" contractual device, they apparently have ignored the physical fact that all supplies of natural gas are not identical but are distinguishable by varying quality differentials. Furthermore, they have ignored the physical realities of the flow of gas within an interstate pipeline system. Both these matters, indeed, must be ignored if the superficial logic of the "restricted use" concept is to have any appeal.

1. Quality Differentials Have Been Ignored.

Lo-Vaca and Houston will rely upon the capability of El Paso to consume *volumes* of gas within its system equivalent to the *volumes* they will sell. However, there is no arrangement, physical or contractual, requiring El Paso to utilize for the specified uses natural gas of a *quality* equivalent to the *quality* of that sold by Lo-Vaca and Houston.

The Lo-Vaca and Houston sales represent different qualities of natural gas. The gas actually delivered by Houston and Lo-Vaca must, under the contracts, meet certain minimum quality specifications. Houston's gas must not have more than 1½ grains of hydrogen sulphide nor more than 30 grains of total sulphur per hundred cubic feet; it may have a maximum of 3% carbon dioxide and a minimum heating content of 950 Btu. (R. 89). Lo-Vaca gas, under both the March and May contracts, may have maximums of 1 grain of hydrogen sulphide and 20 grains of organic sulphur per hundred cubic feet; it may not have more than 2% carbon dioxide and may

not have a heating value of less than 1,000 Btu. (R. 137, 161). Recognizing quality differentials in natural gas supplies is the practice within the industry. Variations in quality may often be the reason for the price differentials which appear in the same producing area.

The Commission also recognizes quality differentials in natural gas. In *Humble Oil & Refining Co.*, 30 FPC 514 (1963), the Commission determined the rate partly on the basis of the surphur content of the gas supply involved. In *Transwestern Pipeline Co.*, 22 FPC 391, 398 (1959), the Commission adjusted price on the basis of carbon dioxide content. In *Northern Natural Gas Co.*, 28 FPC 1155, 1158 (1962), affirmed, 330 F.2d 226 (D.C. Cir. 1964), heating content was a critical factor in price determination. Heating content is, in fact, the subject matter of an investigation presently being conducted by the Commission. *Sunray DX Oil Co.*, 29 FPC 1079 (1963). Also pending before the Commission is a rule-making proceeding, entitled Docket No. R-200, wherein the Commission is considering quality standards to implement its *Statement of General Policy No. 61-1*., 18 C.F.R. Sec. 2.56.

The courts have affirmed the Commission's authority to make quality distinctions in supplies of gas for regulatory purposes. *The Pure Oil Co. v. Federal Power Commission*, 299 F.2d 370 (7th Cir. 1962), involved a Commission finding that a sale of superior quality natural gas at a price higher than that provided for in other contracts did not escalate the prices in the other contracts which involved sales of lower quality gas. The court said:

> "The West Texas contract made available to El Paso gas from two newly developed Permian Basin fields, Emperor Field and South Kermit Field. The record contains evidence that the reserves of these fields are quite substantial; that the fields possess the exceptional quality of gas flow at an extremely high pressure with a consequent delivery potential which makes the gas exceptionally useful for peaking purposes; and the Commission, in agreement with the Examiner, found this quality to be a pertinent factor under the 'higher price' provisions of the Pure contracts which, given due con-

> sideration, sufficiently distinguishes the gas purchases from West Texas from those under the Pure contracts to preclude the payment to West Texas from being regarded as 'higher' than Pure's prices." 299 F.2d at 373.

See also *United Gas Improvement Co. v. Federal Power Commission*, 283 F.2d 817, 823 (9th Cir. 1960), cert. denied, 365 U.S. 879 (1961), holding that substantial variation in quality of gas should be considered in determining initial prices in certificate proceedings.

Houston and Lo-Vaca went to considerable length in their contracts to set down quality specifications. They also went to considerable length to "restrict" their supplies. Yet once their gas is received at Coquat Station and is commingled, all physical identity is admittedly lost. The volumes consumed in Texas will not necessarily have any quality relationship with the actual Houston gas. The same would be true respecting the relationship between Lo-Vaca's actual gas and whatever gas El Paso may consume in New Mexico or Arizona.

The record contains no evidence as to the quality of gas to be sold to Phillips at its plant in Texas, nor the quality or types of gas El Paso will use in its "compressors, treating plants, boilers, camps and other facilities * * *." (R. 149). But one supply of gas is not necessarily the substitute for another supply, no more than one grade of oil is necessarily the substitute for another grade.

In the *Public Utilities Commission* case, *supra*, the energy was distinguishable by use but was also physically the same energy as to each use. In *North Dakota*, *supra*, the "firm" supply and the "dump" supply came out of the tailgate of the same plant and the gas sold in intrastate commerce was apparently the same quality gas that was sold in interstate commerce. In *City of Hastings*, *supra*, the gas used by the city in its power plant was a portion of the same supply which was resold to the city's consumers. The facts in these cases made contractual segregation real and meaningful. In the case at bar such segregation is unreal and meaningless.

2. Contract Language Cannot Alter the Fact of Flow.

Language alone cannot control or change the actual facts. Whether a transaction is in interstate commerce is determined by the essential character of the commerce, not by the contract. *Baltimore & O.S.W.R.R. Co. v. Settle*, 260 U.S. 166, 170 (1922). According to the undisputed facts involved herein, there is no physical segregation of the Lo-Vaca and Houston gas from the gas resold in interstate commerce. The gas is segregated only in the sense that the parties say and imagine it is segregated.

In *Oklahoma Natural Gas Co.*, 23 FPC 291 (1960), the Commission faced a situation similar to the case at bar. Oklahoma Natural Gas Company, a producer of gas in the State of Oklahoma, entered into an agreement with Consolidated Gas Utilities Corporation, an interstate pipeline company, whereby Consolidated would furnish gas to Oklahoma Natural in one part of Oklahoma and would, in turn, receive a like quantity of gas from Oklahoma Natural in another part of the state. Under this exchange agreement Consolidated proposed to sell and deliver for consumption within Oklahoma an amount of gas from its system, now incorporating the supply received from Oklahoma Natural, which would exceed the amount so received from Oklahoma Natural. The Commission found that "it is inevitable that some of Oklahoma Natural's gas commingled with Consolidated gas will be physically transported out of Oklahoma for consumption outside the state." 23 FPC at 293. The Commission further stated:

> "Interstate commerce has taken place here because Oklahoma Natural has delivered gas which is transported outside the state and consumed outside it. This gas has entered the stream of interstate commerce, and has passed across the state border. The fact that the contracting parties agree that Consolidated will deliver to its Oklahoma customers a greater amount of gas does not affect the interstate character of the transaction." 23 FPC at 293.

In *Deep South Oil Co. of Texas v. Federal Power Commission*, 247 F.2d 882 (5th Cir. 1957), a Texas producer of natural gas

argued that its sale of gas at the wellhead to a pipeline company, which, in turn, sold the gas to another pipeline company for resale in interstate commerce, was not subject to Commission jurisdiction because the gas, after delivery, was processed in Texas. The court rejected this argument and rested its decision upon the physical facts:

> "The inescapable fact here then is that at least some portion of the gas sold by petitioner is resold to consumers outside the State of Texas. Consequently, there can be no question that petitioner is making sales for resale within the meaning of the Act." 247 F.2d at 888.

Mere words or intentions are never sufficient to change the physical aspects of commerce. Fiction must yield to fact—in every case.

CONCLUSION

For the foregoing reasons, California prays that the judgment of the United States Court of Appeals for the Fifth Circuit be reversed, and that the orders of the Federal Power Commission involved herein be affirmed.

Respectfully submitted,

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September 17, 1964

(Appendix Follows)

Appendix

RELEVANT PARTS OF STATUTES INVOLVED

The relevant parts of the Natural Gas Act (Act of June 21, 1938, c. 556, 52 Stat. 821-833 (1938), 15 U.S.C. §§ 717-717w (1958)) involved in this proceeding are as follows:

Section 1. (a) As disclosed in reports of the Federal Trade Commission made pursuant to Senate Resolution 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest. [52 Stat. 821, (1938); 15 U.S.C. § 717(a)]

(b) The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas. [52 Stat. 821 (1938); 15 U.S.C. § 717(b)]

(c) The provisions of this Act shall not apply to any person engaged in or legally authorized to engage in the transportation in interstate commerce or the sale in interstate commerce for resale, of natural gas received by such person from another person within or at the boundary of a State if all the natural gas so received is ultimately consumed within such State, or to any facilities used by such person for such transportation or sale, provided that the rates and service of such person and facilities be subject to regulation by a State commission. The matters exempted from the provisions of this Act by this subsection are hereby

declared to be matters primarily of local concern and subject to regulation by the several States. A certification from such State commission to the Federal Power Commission that such State commission has regulatory jurisdiction over rates and service of such person and facilities and is exercising such jurisdiction shall constitute conclusive evidence of such regulatory power or jurisdiction. [68 Stat. 36 (1954); 15 U.S.C. §717(c)]

SEC. 2. When used in this act, unless the context otherwise requires—

(1) "Person" includes an individual or a corporation.

(2) "Corporation" includes any corporation, joint-stock company, partnership, association, business trust, organized group of persons, whether incorporated or not, receiver or receivers, trustee or trustees of any of the foregoing, but shall not include municipalities as hereinafter defined.

(3) "Municipality" means a city, county, or other political subdivision or agency of a State.

(4) "State" means a State admitted to the Union, the District of Columbia, and any organized Territory of the United States.

(5) "Natural gas" means either natural gas unmixed, or any mixture of natural and artificial gas.

(6) "Natural-gas company" means a person engaged in the transportation of natural gas in interstate commerce, or the sale in interstate commerce of such gas for resale.

(7) "Interstate commerce" means commerce between any point in a State and any point outside thereof, or between points within the same State but through any place outside thereof, but only insofar as such commerce takes place within the United States.

(8) "State commission" means the regulatory body of the State or municipality having jurisdiction to regulate rates and charges for the sale of natural gas to consumers within the State or municipality.

(9) "Commission" and "Commissioner" means the Federal Power Commission, and a member thereof, respectively. [52 Stat. 821 (1938); 15 U. S. C. § 717a]

SEC. 7. (a) Whenever the Commission, after notice and opportunity for hearing, finds such action necessary or desirable in the public interest, it may by order direct a natural-gas company to extend or improve its transportation facilities, to establish physical connection of its transportation facilities with the facilities of, and sell natural gas to, any person or municipality engaged or legally authorized to engage in the local distribution of natural or artificial gas to the public, and for such purpose to extend its transportation facilities to communities immediately adjacent to such facilities or to territory served by such natural-gas company, if the Commission finds that no undue burden will be placed upon such natural-gas company thereby: *Provided*, That the Commission shall have no authority to compel the enlargement of transportation facilities for such purposes, or to compel such natural-gas company to establish physical connection or sell natural gas when to do so would impair its ability to render adequate service to its customers. [52 Stat. 824 (1938); 15 U.S.C. § 717f(a)]

(b) No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment. [52 Stat. 824 (1938); 15 U.S.C. § 717f(b)]

(c) No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake

the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: *Provided, however,* That if any such natural-gas company or predecessor in interest was bona fide engaged in transportation or sale of natural gas, subject to the jurisdiction of the Commission, on the effective date of this amendatory Act, over the route or routes or within the area for which application is made and has so operated since that time, the Commission shall issue such certificate without requiring further proof that public convenience and necessity will be served by such operation, and without further proceedings, if application for such certificate is made to the Commission within ninety days after the effective date of this amendatory Act. Pending the determination of any such application, the continuance of such operation shall be lawful.

In all other cases the Commission shall set the matter for hearing and shall give such reasonable notice of the hearing thereon to all interested persons as in its judgment may be necessary under rules and regulations to be prescribed by the Commission; and the application shall be decided in accordance with the procedure provided in subsection (e) of this section and such certificate shall be issued or denied accordingly: *Provided, however,* That the Commission may issue a temporary certificate in cases of emergency, to assure maintenance of adequate service or to serve particular customers, without notice or hearing, pending the determination of an application for a certificate, and may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest. [52 Stat. 825 (1938), as amended, 56 Stat. 83 (1942); 15 U.S.C. § 717f (c)]

(d) Application for certificates shall be made in writing to the Commission, be verified under oath, and shall be in such form, contain such information, and notice thereof shall be served upon such interested parties and in such manner as the Commission shall, by regulation, require. [56 Stat. 84 (1942); 15 U.S.C. § 717f (d)]

(e) Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of the Act and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, construction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require. [56 Stat. 84 (1942); 15 U.S.C. § 717f (e)]

(f) The Commission, after a hearing had upon its own motion or upon application, may determine the service area to which each authorization under this section is to be limited. Within such service area as determined by the Commission a natural-gas company may enlarge or extend its facilities for the purpose of supplying increased market demands in such service area without further authorization. [56 Stat. 84 (1942); 15 U.S.C. § 717f (f)]

(g) Nothing contained in this section shall be construed as a limitation upon the power of the Commission to grant certificates of public convenience and necessity for service of an area already

being served by another natural-gas company. [56 Stat. 84 (1942); 15 U. S. C. § 717f (g)]

(h) When any holder of a certificate of public convenience and necessity cannot acquire by contract, or is unable to agree with the owner of property to the compensation to be paid for, the necessary right-of-way to construct, operate, and maintain a pipe line or pipe lines for the transportation of natural gas, and the necessary land or other property, in addition to right-of-way, for the location of compressor stations, pressure apparatus, or other stations or equipment necessary to the proper operation of such pipe line or pipe lines, it may acquire the same by the exercise of the right of eminent domain in the district court of the United States for the district in which such property may be located, or in the State courts. The practice and procedure in any action or proceeding for that purpose in the district court of the United States shall conform as nearly as may be with the practice and procedure in similar action or proceeding in the courts of the State where the property is situated: *Provided*, That the United States district courts shall only have jurisdiction of cases when the amount claimed by the owner of the property to be condemned exceeds $3,000. [61 Stat. 459 (1947); 15 U. S. C. § 717f (h)]

SEC. 16. The Commission shall have power to perform any and all acts, and to prescribe, issue, make, amend, and rescind such orders, rules, and regulations as it may find necessary or appropriate to carry out the provisions of this act. Among other things, such rules and regulations may define accounting, technical, and trade terms used in this act; and may prescribe the form or forms of all statements, declarations, applications, and reports to be filed with the Commission, the information which they shall contain, and the time within which they shall be filed. Unless a different date is specified therein, rules and regulations of the Commission shall be effective thirty days after publication in the manner which the Commission shall prescribe. Orders of the

Commission shall be effective on the date and in the manner which the Commission shall prescribe. For the purposes of its rules and regulations, the Commission may classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters. All rules and regulations of the Commission shall be filed with its secretary and shall be kept open in convenient form for public inspection and examination during reasonable business hours. [52 Stat. 850 (1938); 15 U.S.C. § 717o]